

Message Text

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ACTION AF-10

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FM AMEMBASSY NAIROBI

TO SECSTATE WASHDC 8181

INFO AMEMBASSY DAR ES SALAAM

AMEMBASSY KHARTOUM

AMEMBASSY ADDIS ABABA

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E. O. 11652: N/A

TAGS: EGEN, BGEN, KE

SUBJ: KENYAN ECONOMY COPING WITH RECORD FOREIGN EXCHANGE
RESERVES

REF: NAIROBI 1026, NAIROBI 5377

1. SUMMARY: KENYA'S FOREIGN EXCHANGE RESERVES INCREASED
74 PERCENT OVER LAST FOUR MONTHS, THANKS TO UNUSUALLY HIGH
EARNINGS FROM COFFEE AND TEA EXPORTS. WITH LOCAL BANKS UNABLE
TO PUMP THIS SUDDEN WEALTH INTO PRODUCTIVE INVESTMENTS, GOK
MAY HAVE TO STERILIZE EXCHANGE FLOWS BY IMPOSING NEW TAXES
OR ESTABLISHING COMMODITY FUND TO STABILIZE PRICE VOLATILITY
OVER NEXT FEW YEARS. END SUMMARY

2. COFFEE AND TEA EXPORT RECEIPTS HAVE CONTRIBUTED TO
RECORDHIGH KENYAN FOREIGN EXCHANGE EARNINGS. AS OF MAY 9
CENTRAL BANK HAD ACCUMULATED \$486 MILLION, AND INCREASE OF
OVER \$200 MILLION SINCE JAN 1. ONE YEAR AGO RESERVES STOOD
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AT \$173 MILLION. CURRENT SUM OFFERS APPROXIMATELY SIX MONTHS'
IMPORT COVERAGE, DOUBLE WHAT IS TRADITIONALLY CONSIDERED A
"SAFE" MARGIN IN THIS COUNTRY. STRONG EXPORT PERFORMANCE IN
LATE 1976 CAUSED CENTRAL BANK TO INCREASE ESTIMATE FOR 1976
BALANCE OF PAYMENTS SURPLUS TO \$83.9 MILLION. BANK PROJECTIONS
CALL FOR SLIGHTLY LARGER SURPLUS IN 1977 BUT SEE COOFFEE
REVENUES LEVELLING OFF OR EVEN DROPPING IN MID 1978.

3. EXTRAORDINARILY HIGH POSITION HAS BEEN MIXED BLESSING TO KENYAN ECONOMY. IN RECENT CONSULTATIONS WITH IMF STUDY GROUP (JANUARY AND APRIL), CENTRAL BANK RECOMMENDATION FOR TEMPORARY STERILIZATION OF FOREIGN EXCHANGE INFLOWS WAS STRONGLY ENDORSED BY IMF TEAM. POSSIBLE ACTIONS WOULD BE EXPORT TAX ON COFFEE AND CENTRAL BANK-ADMINISTERED BUFFER FUND. LATTER WOULD SOAK UP EXCESS COFFEE EARNINGS IN WIND-FALL YEARS AND FEED BACK PROCEEDS TO FARMERS IN FUTURE LEAN SEASONS. ACCORDING TO CENTRAL BANK OFFICIAL, GOK TREASURY BALKED AT IDEA OF PUTTING KENYA'S NEW FORTUNE ON ICE, FEARING ADVERSE POLITICAL REACTION (FINANCE MINISTER IS LEADING CONTENDER FOR POSITION OF NATIONAL CHAIRMAN OF KENYA'S SOLE POLITICAL PARTY).

4. UNDER LOCAL BANKING REGULATIONS, CENTRAL BANK BUYS UP FOREIGN EXCHANGE FROM COMMERCIAL BANKS AND ISSUES COUNTERPART SHILLING FUNDS. BANKS ARE USUALLY EAGER TO RECYCLE SHILLINGS THROUGH ECONOMY BY MEETING PRIVATE CREDIT DEMANDS FOR INVESTMENT AND TRADE FINANCING. OVER LAST YEAR, HOWEVER, EXPORT REVENUE HAS ACCUMULATED FASTER THAN ECONOMY'S ABILITY TO PRODUCTIVELY ABSORB THIS EXTRA MONEY. MOST BANKS HAVE EVEN STOPPED CLAIMING THEIR SHILLING COUNTERPARTS FROM THE CENTRAL BANK; THEREFORE LATTER HAS AMASSED A BILLION SHILLINGS IN IDLE RESERVES. LIQUIDITY RATION OF LOCAL BANKS NOW AN AVERAGE 30 PERCENT. REACTING TO SURFEIT OF CASH, SOME BANKS HAVE REPORTEDLY STOPPED ACCEPTING TIME DEPOSITS, ON WHICH THEY ARE OBLIGED TO PAY INTEREST.

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5. COMFORTABLY HIGH EXCHANGE LEVEL HAS ENCOURAGED CENTRAL BANK TO CONSIDER POSSIBILITY OF LIBERALIZING KENYA'S IMPORT LICENSING CONTROLS. UNDER PROPOSAL NOW BEING STUDIED BY BANK, FOURTH SCHEDULE IMPORTS (I.E. THOSE FOR WHICH NO FOREIGN EXCHANGE WILL BE RELEASED) WOULD BE ABOLISHED. ITEMS ON SECOND AND THIRD SCHEDULES WOULD BE DRASTICALLY REDUCED. FIRST SCHEDULE AND OPEN GENERAL LICENSE, PARTICULARLY LATTER, WOULD BE EXPANDED. IN GENERAL, IMPORT RESTRICTIONS WOULD BE MAINTAINED ONLY IN CASES WHERE LOCAL INDUSTRIES REQUIRED PROTECTION. FINANCE MINISTER'S BUDGET MESSAGE IN MID-JUNE COULD INTRODUCE LICENSING AMENDMENTS AND OTHER BENEFITS TO BUSINESS COMMUNITY.

6. RAPIDLY INCREASING FOREIGN RESERVES COINCIDE WITH GROWING BUDGET DEFICITS, WHICH ARE SOURCE OF PARTICULAR CONCERN TO CENTRAL BANK. BANK OFFICIAL STATED THAT IMF CONSULTATION TEAMS WERE UNHAPPY NOT ONLY WITH GOK INABILITY TO DISCIPLINE FISCAL PERFORMANCE BUT ALSO TREASURY'S ATTEMPTS TO MUTE SIZE OF OVERRUNS BY MANIPULATING FINANCIAL STATISTICS PROVIDED

FUND. BANK PARTICIPANT IN RECENT CONSULTATIONS REPORTED THAT IMF TEAMS WARNED GOVERNMENT THAT ITS CREDIBILITY IN INTERNATIONAL FINANCIAL COMMUNITY WAS AT STAKE UNLESS EXPENDITURES BROUGHT UNDER CONTROL BY MORE EFFECTIVE INTERNAL ACCOUNTING. TREASURY'S SOLUTION WAS APPARENTLY TO SUGGEST THAT EXCHANGE RESERVES BE EMPLOYED TO COVER BUDGET GAP.

7. COMMENT: AFTER TWO YEARS OF BELT-TIGHTENING DURING OIL CRISIS, KENYAN MONETARY AUTHORITIES ARE AWKWARDLY GRAPPLING WITH PROBLEMS OF SUDDEN "WEALTH." GOK'S POLICY OF CAUTIOUS RESTRAINT, WHICH WORKED RATHER WELL IN MANAGING DOMESTIC DEMAND DURING DIFFICULT POST-1973 PERIOD, SEEMS UNADAPTED TO ECONOMY'S PRESENT NEED FOR STIMULATED INVESTMENT AND EXPANDED EMPLOYMENT OPPORTUNITIES. FINANCE MINISTER'S FORTHCOMING BUDGET SPEECH, MID-JUNE, WILL HAVE TO ADDRESS THIS DILEMMA OF STIMULATING ECONOMY AT RISK OF STOKING INFLATION, WHICH IS TREATENING AGAIN REACH 15 PERCENT LEVEL, LIMITED OFFICIAL USE

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OR RESTRAINING CIRCULATION OF EARNINGS AT EXPENSE JOBS.

DECONTROL 5/13/78.
BROWN

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